

Including Management's Discussion and Analysis in Annual Reports and Financial Statements

The original recommended practice was developed by the Government Finance Officers Association (GFOA). Some aspects of the practice have been revised by the Financial Management Capacity Building Committee (FMCBC) for use by Nova Scotia municipal governments. The original GFOA recommended practice is *Including Management's Discussion and Analysis in Departmental Reports*, approved by the GFOA in 2004. Other sources used are footnoted in the text.

Recommendation

The GFOA recommends that municipalities include a Management's Discussion and Analysis (MD&A) document as part of its annual report to taxpayers and stakeholders. The GFOA also recommends that a municipality's MD&A be presented in conjunction with departmental reports, individual fund reports, and similar reports. MD&A's should be classified as supplementary information to basic financial statements.

Purpose

The purpose of an MD&A is to provide an objective and easily readable analysis of the municipality's financial activities based on currently known facts, decisions, or conditions. The MD&A can provide taxpayers with readable information surrounding municipal management's framework for decision making. The MD&A assists taxpayers and stakeholders to hold the municipality more accountable. The MD&A can be a benchmark to determine if the municipality is meeting its stated objectives in its strategic plan. Also, an effective MD&A can strengthen internal management focus.¹

Background

The CICA recommends that governments develop an MD&A with its annual report or its financial statements. Developing an MD&A is not a Public Sector Accounting Board standard or requirement, but the CICA does offer information on developing an MD&A and how to properly disclose information.²

¹ The Canadian Institute of Chartered Accountants. Management's Discussion and Analysis Guidance on Preparation and Disclosure.
http://www.cica.ca/multimedia/Download_Library/Research_Guidance/MDandA_Business_Reporting/E_MDAFull_1.pdf.

² Ibid.

MD&A is supplemental analysis and explanation that accompanies a municipality's financial statements. MD&A provides management with the opportunity to explain, in narrative form, its current financial situation and future prospects. An MD&A is intended to give taxpayers and stakeholders the ability to look at the municipality through the eyes of management by providing both a historical and prospective analysis. The MD&A can also discuss the dynamics of the municipality and an analysis of the financial statements. Combined with the financial statements, this information should allow taxpayers and stakeholders to better assess a municipality's performance and future prospects.³

Considerations for Policy Development

Municipalities should consider developing an MD&A reporting document to provide its taxpayers and stakeholders with a greater understanding of its activities and decisions, thereby creating greater accountability. Although there is no standard format to follow when developing an MD&A, there are some aspects that should be included in an MD&A report to uphold accountability. *Appendix I* outlines the various aspects that should be included in an MD&A.

In order for an MD&A to be effective in promoting accountability, municipalities need to exercise proper disclosure. *Appendix II* includes some general principles on disclosure, as well as how to continue executing effective disclosure.

Since MD&A reporting is not common among Canadian municipalities, there are not many Canadian examples to examine. The North Carolina Department of State Treasurer created an MD&A template, which some municipalities may find useful. This document can be found at:

http://www.treasurer.state.nc.us/NR/rdonlyres/0E4BA11E-EAF9-440A-A1B8-2C34DD085497/0/Blank_MDA_City05.doc.

For further information on MD&A reporting, the CICA website offers helpful information. The following website link can help municipalities in developing their own MD&A report: http://www.cica.ca/index.cfm/ci_id/247/la_id/1.

Appendices

Appendix I: Components of an MD&A

Appendix II: General Disclosure Principles for an MD&A

³ OSC Policy Statement NO. 5.10 – Amendments and Additional Items.

Appendix I: Components of an MD&A

Municipalities should include information in its MD&A that provides the taxpayers and stakeholders with a greater understanding of the municipality and the decisions made that affect the community. Most municipalities already provide many aspects of this information, but it is not always presented in a single, succinct disclosure document. The MD&A should communicate financial information, but also relevant and material non-financial information.

Introduction

In order for the readers of an MD&A to understand the information, municipalities should establish a comprehensive introduction. The introduction of an MD&A should include the municipality's vision and core strategy, an explanation of what will be discussed in the MD&A, and the municipality's financial highlights.

Vision and Core Strategy

- The MD&A should disclose the municipality's vision, core businesses, including all significant segments, and key features of its business strategy.
- The MD&A should disclose the underlying rationale, context and factors considered by the municipality in developing its strategy. This rationale would relate to both internal and external factors, and to opportunities and risks.⁴

Explanation of MD&A

- Municipalities could include a section explaining the different sections that will be presented in the MD&A. This could provide the readers with a greater appreciation and understanding of the sections that will be discussed.
- Municipalities could also to include a description on how management interprets these financial documents. This can help the readers further understand how the municipality makes its decisions.⁵

Financial Highlights

- Municipalities could include a short statement outlining the financial aspects of the municipality. This could include:
 - Total assets and liabilities
 - Increase/decrease of assets and liabilities from previous year
 - Total debt.⁶

⁴ The Canadian Institute of Chartered Accountants. Management's Discussion and Analysis Guidance on Preparation and Disclosure. http://www.cica.ca/multimedia/Download_Library/Research_Guidance/MDandA_Business_Reporting/E_MDAFull_1.pdf.

⁵ State of South Dakota. Municipality of _____ Management's Discussion and Analysis December 31, 20YY.

⁶ North Carolina Department of State Treasurer. Management's Discussion and Analysis Template. August 2005. http://www.treasurer.state.nc.us/NR/rdonlyres/0E4BA11E-EAF9-440A-A1B8-2C34DD085497/0/Blank_MDA_City05.doc.

Financial Condition

The MD&A should include a discussion of the municipality's financial condition, an explanation of its financial statements, and its capital resource capabilities. This can provide the reader with an understanding of the condition of the municipality, which can help the readers understand the decisions that the municipal administrators and Councilors may make.

Explanation of Financial Statements

- This section can help the readers understand if the municipality is better or worse off as a result of the previous year's activities.
- The explanation of the meaning of the various financial statements found in a municipality's budget can help taxpayers and stakeholders have a greater understanding of the financial statements.
- Municipalities could include discussions on:
 - Basic Financial Statements;
 - Fund Financial Statements;
 - Governmental Funds;
 - Reserve and Trust Funds; and
 - Notes to Financial Statements.⁷
- By understanding the meaning behind the various financial statements, taxpayers and stakeholders can begin to appreciate how the municipality's revenues were spent.⁸

Factors Affecting the Current Position

There are many different factors that can affect how a municipality handles its expenditures and revenues. These factors are comprised of internal and external factors, and past and future situations. Municipalities should include a discussion of the factors affecting the municipalities to help its readers understand the issues surrounding the decisions made by administrators and Councilors. Municipalities should include:

- A description of changes in the financial condition;
- An explanation of how a municipality collects its revenues and spends its expenditures;
- An analysis of financial statements;
- A description of any significant changes; and
- The impact of accounting policy changes.

⁷ North Carolina Department of State Treasurer. Management's Discussion and Analysis Template. August 2005. http://www.treasurer.state.nc.us/NR/rdonlyres/0E4BA11E-EAF9-440A-A1B8-2C34DD085497/0/Blank_MDA_City05.doc.

⁸ State of South Dakota. Municipality of _____ Management's Discussion and Analysis December 31, 20YY.

Changes in Financial Condition

- The MD&A should explain why changes have or have not occurred in the financial condition and results of operations of the municipality.
- This should include a discussion of the effect of discontinued operations and extraordinary items where these items have had or are expected to have an effect on the financial condition and results of operations of the municipality.
- Municipalities could include the change in total assets over 2-5 years.
- Furthermore, municipalities should describe the causes of changes in the financial statements from year to year, to the extent necessary to understand the municipality as a whole.⁹

Revenues and Expenditures

- This section of the MD&A should be a description of the various channels where the municipality acquired its revenues.
- This can be divided into different sections based on the type of revenue (tax revenue, fees or charges revenues, or grants).¹⁰
- Municipalities should explain how significant changes might affect the municipality, taxpayers, and stakeholders in the future.
- A description of the municipality's economic factors and next year's budget rates, or any potential tax rate increases or decreases should be included.
- This section can include a projection of future decisions and spending capabilities to provide the readers with the municipality's strategic vision.¹¹

Financial Statement Analysis

- Municipalities should disclose their financial statements in the MD&A.
- Municipalities could discuss its various funds, such as:
 - Governmental Funds;
 - General Fund Budgetary Highlights; and
 - Reserve and Trust Funds.¹²
- Financial statement discussions should include current and last year's figures to explain any variances. The variances should be explained by percentage, and areas with larger variances should be provided with greater detail.¹³

⁹ OSC Policy Statement NO. 5.10 – Amendments and Additional Items.

¹⁰ State of South Dakota. Municipality of _____ Management's Discussion and Analysis December 31, 20YY.

¹¹ Town of Limon, Colorado. Management's Discussion and Analysis December 31, 2005.
http://www.townoflimon.com/Gov/Audit/2004/p6_15.pdf.

¹² North Carolina Department of State Treasurer. Management's Discussion and Analysis Template. August 2005. http://www.treasurer.state.nc.us/NR/rdonlyres/0E4BA11E-EAF9-440A-A1B8-2C34DD085497/0/Blank_MDA_City05.doc.

¹³ Town of Limon, Colorado. Management's Discussion and Analysis December 31, 2005.

Explanation of Significant Changes

- Municipalities should reserve a section of the MD&A to provide detailed explanation of significant changes in its expenditures or revenues from the previous year.
- This can help taxpayers and stakeholders have a better understanding of how the municipality is spending their money, and how an increase in tax rates could be explained.¹⁴

Impact of Accounting Policies

- Municipalities should disclose the estimated effect on financial statements of the implementation of any changes in accounting policies.
- This could include accounting policies adopted after the most recent fiscal year end or the effects of expected accounting changes that have not been implemented.¹⁵

Capital Assets and Debt Administration

Municipalities should include a section discussing its capital assets and debt administration in the MD&A. This can provide the readers with an understanding of how a majority of its budget is being allocated, and how the debt is managed. Readers should be able to understand these very important aspects.

Capital Assets

- Municipalities should include how much was invested for government and business activities during the fiscal year. This could include a description of:
 - Construction of water and sewer capital assets;
 - Construction in progress;
 - Major acquisitions; and
 - Major demolitions.¹⁶

Capital Resources Capabilities

- Commitments for capital expenditures and the general purpose of the commitments should be described and quantified. The anticipated source of funds needed to fulfil the commitments should also be disclosed.
- Favourable or unfavourable trends in the municipality's capital resources should be described. Any expected changes relative to these resources should also be indicated. Furthermore, other sources of financing that have been arranged but not yet utilized should be addressed.¹⁷

¹⁴ State of South Dakota. Municipality of _____ Management's Discussion and Analysis December 31, 20YY.

¹⁵ OSC Policy Statement NO. 5.10 – Amendments and Additional Items.

¹⁶ North Carolina Department of State Treasurer. Management's Discussion and Analysis Template. August 2005. http://www.treasurer.state.nc.us/NR/rdonlyres/0E4BA11E-EAF9-440A-A1B8-2C34DD085497/0/Blank_MDA_City05.doc.

¹⁷ OSC Policy Statement NO. 5.10 – Amendments and Additional Items.

Long-Term Debt

- The MD&A should include the municipality's current outstanding debt, and the municipality's planned schedule to repay the debt.¹⁸

Factors Affecting Decisions

There are a variety of factors affecting municipality's decisions. When developing an MD&A, municipalities should include a discussion of a municipality's basis of accounting, government activity, liquidity, and a prospective analysis. All of these factors are involved in key decisions within a municipality, and they should be addressed in an MD&A.

Basis of Accounting

- Municipalities should explain its basis of accounting and how the materials are recorded. This can provide greater context and understanding for readers.¹⁹

Government Activity

- The MD&A should include a description of how government spending affects tax rates.
- This section could provide a greater understanding for taxpayers and stakeholders on how their tax dollars are spent and why taxes may increase.²⁰

Economic Factors

- Municipality's decisions are often affected by past, current, and future economic conditions. It is important to discuss and address the economic factors that may be particularly influential:
 - Employment rate;
 - New jobs created; and
 - Occupancy rate of office and retail space.²¹

Liquidity

- The discussion of liquidity should focus on the ability of the municipality to generate adequate amounts of cash and cash equivalents when needed. The discussion of liquidity and capital resources should focus on both short-term and long-term needs. Generally, short-term liquidity and short-term capital resources relate to cash needs for the fiscal year.²²

¹⁸ North Carolina Department of State Treasurer. Management's Discussion and Analysis Template. August 2005. http://www.treasurer.state.nc.us/NR/rdonlyres/0E4BA11E-EAF9-440A-A1B8-2C34DD085497/0/Blank_MDA_City05.doc.

¹⁹ State of South Dakota. Municipality of _____ Management's Discussion and Analysis December 31, 20YY.

²⁰ Ibid.

²¹ North Carolina Department of State Treasurer. Management's Discussion and Analysis Template. August 2005. http://www.treasurer.state.nc.us/NR/rdonlyres/0E4BA11E-EAF9-440A-A1B8-2C34DD085497/0/Blank_MDA_City05.doc.

²² OSC Policy Statement NO. 5.10 – Amendments and Additional Items.

- When discussing liquidity, the MD&A should:
- Identify any known trends or expected fluctuations in the municipality's liquidity, taking into account known demands, commitments, events, or uncertainties.
- Describe balance sheet conditions, revenue, or cash flow items that affect the municipality's liquidity condition.²³

Prospective Analysis

- The MD&A should provide an analysis of future prospects for the municipality. This analysis should entail a discussion of the municipality's outlook, including discussion and disclosure of significant goals, objectives, or targets.
- When disclosing information on future prospects, municipalities should also disclose the key underlying assumptions, including related risks and uncertainties, and the potential impact of significant changes to the key assumptions.
- MD&A's should include appropriate cautionary language to alert readers to the uncertainty inherent in information about future prospects.²⁴

Risk Management

A municipality should disclose its significant risks and describe its risk management systems to enable readers to understand and evaluate the risks and its decisions regarding the management of risks. Municipalities should ensure that there is continuity and consistency from one period to another when discussing risk and how the risk impacts results.²⁵

Risks and Uncertainties

- Municipalities should disclose information on its risks and uncertainties, changes in its financial condition, and the results of operations.
- Emphasis should be placed on disclosing risks and uncertainties likely to be factors within the next two years.²⁶

Significant Activities

- When a municipality intends to proceed with an irregular acquisition, disposition, or asset that will have a material effect on the future financial condition or results of the municipality, the transaction and its effect should be discussed as part of the MD&A.²⁷

²³ OSC Policy Statement NO. 5.10 – Amendments and Additional Items.

²⁴ The Canadian Institute of Chartered Accountants. Management's Discussion and Analysis Guidance on Preparation and Disclosure.
http://www.cica.ca/multimedia/Download_Library/Research_Guidance/MDandA_Business_Reporting/E_MDAFull_1.pdf.

²⁵ Ibid.

²⁶ OSC Policy Statement NO. 5.10 – Amendments and Additional Items.

²⁷ Ibid.

Appendix II: General Disclosure Principles for an MD&A

In order for an MD&A to be effective, municipalities need to be honest in their reporting, and report information that is useful to its taxpayers and stakeholders. The following are disclosure principles offered by the CICA that can help municipalities develop a comprehensive MD&A.

1. *Through the Eyes of Management*

A municipality should disclose information in its MD&A that enables taxpayers and stakeholders to view the municipality through the eyes of management.

2. *Integration with Financial Statements*

MD&A should complement as well as supplement financial statements.

3. *Completeness and Materiality*

To be reliable, MD&A should be complete, fair, balanced, and provide information that is material to the decision-making needs of readers.

4. *Forward-Looking Orientation*

A forward-looking orientation is fundamental to useful MD&A reporting.

5. *Strategic Perspective*

The focus of MD&A's should be on the municipality's strategy for generating value for taxpayers and stakeholders over time.

6. *Usefulness*

To be useful, MD&A's should be written in plain language, presented in a straightforward format, and without exaggeration. The document should be relevant, understandable, comparable, and consist over reporting periods.²⁸

Continuity and Disclosure

Municipalities should consider taking the following steps to ensure that they continue with the MD&A process and exercise proper disclosure.

Disclosure Policy

- MD&A reporting should be addressed within a municipality's disclosure policy as an integral component of continuous disclosure policies and practices.²⁹

²⁸ The Canadian Institute of Chartered Accountants. Management's Discussion and Analysis Guidance on Preparation and Disclosure.
http://www.cica.ca/multimedia/Download_Library/Research_Guidance/MDandA_Business_Reporting/E_MDAFull_1.pdf.

²⁹ Ibid.

Role of MD&A in Continuous Disclosure

- A municipality should use MD&A reporting, both annual and interim, to gather, integrate, and present information significant to taxpayers and stakeholders. In addition, municipalities should update previous disclosures about strategy, key performance drivers, capabilities, risks, and results. Consequently, all significant information will remain disclosed and kept current through the MD&A.
- Where a municipality has determined that a change has occurred and has disclosed this to the public, its subsequent MD&A report should incorporate and reflect that disclosure. Municipalities should also provide appropriate further analysis to reflect the change on the municipality's view.³⁰

Interim MD&A Reports

- A municipality should use its interim MD&A to present its analysis of results and cash flow for the reporting period and year to date and financial condition at the end of the period. In addition, the municipality should update previous disclosures about strategy, key performance drivers, capabilities, risk, results, and any related supporting rationale.
- The analysis of actual results in an interim MD&A should include a discussion of progress against previously disclosed goals, objectives, or targets.
- Municipalities should consider issuing fourth quarter MD&A's separate from annual MD&A's, particularly where there is an extended period of time between the end of the fourth quarter and the release of the annual report.³¹

³⁰ The Canadian Institute of Chartered Accountants. Management's Discussion and Analysis Guidance on Preparation and Disclosure.
http://www.cica.ca/multimedia/Download_Library/Research_Guidance/MDandA_Business_Reporting/E_MDAFull_1.pdf.

³¹ Ibid.

References

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<http://www.gfoa.org/services/rp/MDArevised.rtf>.

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The Canadian Institute of Chartered Accountants. Management's Discussion and Analysis Guidance on Preparation and Disclosure.
http://www.cica.ca/multimedia/Download_Library/Research_Guidance/MDandA_Business_Reporting/E_MDAFull_1.pdf.

Town of Limon, Colorado. Management's Discussion and Analysis December 31, 2005.

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